UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	§	
This Document Relates To:	§	
MARK NEWBY, *et al.*, individually and on behalf of all others similarly situated,	§	
Plaintiffs,	§	Civil Action No. H-01-3624 (Consolidated)
vs.	§	
ENRON CORP., *et al.*	§	
Defendants.	§	
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, *et al.*, individually and on behalf of all others similarly situated,	§	
Plaintiffs,	§	
vs.	§	
KENNETH L. LAY, *et al.*	§	
Defendants.	§	

MEMORANDUM IN SUPPORT OF MOTION TO DISMISS OF LEHMAN BROTHERS HOLDINGS INC.

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I. INTRODUCTION

Plaintiffs' Consolidated Complaint for Violation of the Securities Laws (the "Complaint") spans 500 pages not because it details the alleged misstatements and knowledge of each defendant with the specificity required by Federal Rule of Civil Procedure 9(b) and the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), but because it is replete with commentary and argument, reams of editorial quotations, and rhetorical excess. The Complaint thus dramatically extends a type of pleading abuse that has been repeatedly condemned by the courts. As the Fifth Circuit has held, verbose and circuitous allegations do not mark specificity in pleading fraud but in fact signal just the opposite: "A complaint can be long-winded, even prolix, without pleading with particularity. Indeed, such a garrulous style is not an uncommon mask for an absence of detail." *Williams v. WMX Techs., Inc.*, 112 F.3d 175, 178 (5th Cir. 1997).

Notwithstanding its length, the Complaint never answers a critical question: Why is *Lehman* a defendant? Even among the defendants newly added to this case, the allegations against Lehman are notably scant and inadequate. Plaintiffs spare no ink in describing the ways in which Enron insiders allegedly cooked the company's books with the assistance of Arthur Andersen. But according to the Complaint, Lehman's "participation" in the alleged scheme consisted of nothing more than having provided banking services to Enron, a legally inactionable charge rendered even more defective by the fact that the Complaint is devoid of specific facts showing that Lehman acted with scienter. The Complaint thus seems to be drafted on the premise that, in this climate, it is enough for plaintiffs to fashion an alleged, massive fraudulent "scheme" by Enron and charge that Lehman was part of the scheme simply because it did business with Enron. The Complaint, in short, pleads guilt by association. But that will not do.

Given that plaintiffs allege no factual basis for a claim against Lehman, the reason why Lehman is named as a defendant is all too clear: to add yet another "deep pocket" to the growing cast of lawyers, banks, and other potential contributors to plaintiffs' hoped-for recovery in the wake of Enron's bankruptcy and Arthur Andersen's well-publicized troubles. This plainly does not justify Lehman's addition to this case.

As shown below, plaintiffs' claims against Lehman for violation of federal and state securities laws fail for at least the following reasons:

First, plaintiffs' Section 10(b) and Rule 10b-5 claims seek to impose liability on Lehman for aiding and abetting the Enron defendants' alleged fraud — conduct the Supreme Court has expressly held does *not* constitute a violation of the securities laws. *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 180 (1994). Not surprisingly, plaintiffs try to cast their claims as ones for primary liability. But their effort fails. Indeed, plaintiffs *repeatedly* describe Lehman's alleged "participation" as "help[ing]" Enron carry out a "fraudulent scheme." These are not a few ill-chosen words, but the deliberate wording of plaintiffs, which reflects the substance of their claims.

Second, in their Section 10(b) and Rule 10b-5 claims, plaintiffs totally fail to plead facts creating a "strong inference of scienter" as required by the PSLRA. They do no more than assert that Lehman "knew" that Enron was engaged in a fraudulent scheme because Lehman was one of its bankers. Plaintiffs do not plead a single fact showing Lehman's knowledge of any fraud. Thus, this is but another case based on allegations that those providing financial services to the issuer "must have known." This and other courts have rejected any such notion. *See, e.g., Kurtzman v. Compaq Computer Corp.,* No. H-99-779, slip op. *passim* (S.D. Tex. Apr. 1, 2002) (Harmon, J.).

Coupled with this conclusory charge are rote allegations that Lehman had financial motives to "participate" in a fraudulent scheme because it could lead to future banking fees and interest on unidentified loans. These very same kinds of allegations also have been rejected as "a mockery of Rule 9(b)." *Melder v. Morris*, 27 F.3d 1097, 1104 (5th Cir. 1994). They do not even make sense. They attribute to Lehman the irrational behavior of putting its own money and reputation at risk on Enron, which it supposedly knew to be a "hall of mirrors inside a house of cards," all for the mere *possibility* of one day earning banking fees in the off chance Enron did not first collapse. Such illogical allegations negate, rather than support, any inference of scienter.

Third, plaintiffs completely fail to meet their obligations under Rule 9(b) and the PSLRA of (1) specifying each material misstatement of fact by Lehman, (2) showing with specific, contrary facts why it was false or misleading, and (3) showing, again with specific facts, who at Lehman knew each statement was false, and how and when the contrary facts were known. Rather, the Complaint lumps together hundreds of quotations and excerpts from statements of various defendants (and third parties) and then applies broad-brush allegations that they were *all* false and misleading based on a litany of allegedly "true but concealed facts." This type of pleading has been repeatedly condemned. As the Fifth Circuit observed, it is a routine cover-up "for an absence of detail." *Williams*, 112 F.3d at 178.

Fourth, plaintiffs' Section 11 claims and the claim of plaintiff Washington State Investment Board ("Washington Board") under the Texas Securities Act are flawed because they are based on the same facially deficient fraud allegations on which plaintiffs' Section 10(b) and Rule 10b-5 claims are based.

Fifth, Washington Board's Texas Securities Act claim additionally fails because it does not allege any nexus between the alleged sale of securities and this State.

For all of these reasons, and additional reasons explained more fully below, the Complaint should be dismissed with prejudice as to Lehman pursuant to Rules 8(a), 9(b) and 12(b)(6) and the PSLRA.

II. THE ALLEGATIONS OF THE COMPLAINT

What is most remarkable about the Complaint for purposes of this Motion is not its mere length but that in such a verbose pleading so little is said about Lehman, and of that, so little is specific. Plaintiffs seek to tar Lehman with Enron's misdeeds and collapse, but are at a loss for specific facts to support a claim of fraud.[1]

The Complaint alleges that Enron insiders orchestrated a "scheme" to inflate and falsify Enron's reported profits and financial condition. (Compl. ¶¶ 2-3.) This multifarious fraud allegedly was carried out through Enron's use of "clandestinely controlled" partnerships and special purpose entities ("SPEs") to conceal debts and losses (*e.g.*, *id.* ¶ 4), various and sundry "improper accounting tricks" and revenue-recognition practices (*id.* ¶ 18), and "bogus" transactions designed to appear as legitimate loans, risk hedges, or swaps (*id.* ¶¶ 33, 34, 43-47, 62). According to plaintiffs, Enron became a "Ponzi scheme," "borrowing billions of dollars in the commercial paper markets" (from the very banks who allegedly knew it was a "Ponzi scheme"), and "constantly raising money from public offerings of its securities or those of related entities to sustain itself, while appearing to achieve successful growth and profits." (*Id.* ¶¶ 18, 48.)

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[1] Plaintiffs have not even sued the correct party. Defendant Lehman Brothers Holdings Inc. did not in fact engage in any of the activities described in the Complaint. Rather, as the Complaint itself acknowledges, banking and advisory services are provided only by its subsidiaries (Compl. ¶ 108), in this case, Lehman Brothers Inc.

Despite 500 pages of such sweeping claims, plaintiffs' allegations against Lehman are vanishingly few. They allege, in general terms only, that Lehman provided commercial and investment banking services to Enron, and then boldly assert that Lehman "*engaged and participated in the scheme to defraud* purchasers of Enron securities . . . *by rendering all of the above services to Enron* as described in greater detail in the section of this complaint entitled 'Involvement of Lehman Brothers.'" (*Id.* ¶ 108 (emphasis added).) Almost 300 pages later, plaintiffs finally purport to address that topic — how Lehman's *rendering of banking services* somehow constituted fraud on the securities markets. But the Complaint does not deliver on its misconceived promise.

A. Lehman's Alleged Help In Falsifying Enron's Financial Statements

First, plaintiffs make the conclusory charge that Lehman "*helped* Enron falsify its financial statements and misrepresent its financial condition." (*Id.* ¶ 762 (emphasis added).) In all its pages, the Complaint fails to provide a single fact to support that allegation. Not one instance is identified.

B. Lehman's Investment In LJM2

Second, plaintiffs allege that Lehman "*helped* [Enron] structure and finance certain of the illicit SPEs and partnerships Enron controlled which were primary vehicles utilized *by Enron* to falsify its reported financial results." (*Id.* ¶ 763 (emphasis added).) The sole connection between Lehman and any Enron-affiliated entity alleged in the Complaint, however, is that Lehman was solicited by Merrill Lynch to invest, and did invest, "at least $10 million" in the limited partnership known as LJM2. (*Id.* ¶¶ 25, 26, 461, 647, 762, 770.) But plaintiffs do not allege that Lehman helped set up LJM2. To the contrary, plaintiffs contend that "LJM2 was a privately held entity created by Enron with the help of Merrill Lynch, Andersen, Vinson & Elkins and Kirkland & Ellis at year-end 99." (*Id.* ¶ 646.)

Although plaintiffs never allege that Lehman made any misrepresentations about its investment in LJM2, they nevertheless claim that the investment *itself* was actionable securities fraud because it allowed Enron to "do deals in late 99 to artificially inflate Enron's reported 99 profits." (*Id.* ¶ 770.) According to plaintiffs, "Enron [sic] doing the 99 year-end deals with the [sic] LJM2 and its SPEs was indispensable to Enron avoiding reporting a very bad 4thQ 99 – which would have caused its stock to plunge." (*Id.* ¶ 28.) Nowhere does the Complaint say, however, that Lehman was involved in any way in any year-end deals between Enron and LJM2, or even how or what Lehman specifically knew about any of those deals or Enron's alleged use of LJM2 to inflate its profits.

C. Lehman's Underwriting Of Certain Enron Securities Offerings

Third, plaintiffs allege that Lehman participated in the fraudulent scheme because it "*helped* Enron and its related entities raise over $4 billion from the investing public via the sale of securities during the Class Period." (*Id.* ¶ 763.) Plaintiffs list six securities offerings for which Lehman is alleged to have been one of the underwriters during the alleged Class Period (*id.* ¶¶ 765, 766), but Lehman actually was involved in only four of them.[2]

D. Lehman's Stock Analyst Reports

Fourth, plaintiffs allege that "Lehman Brothers issued analysts' reports on Enron which contained false and misleading statements concerning Enron's business, finances and financial

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[2] Lehman did not in fact underwrite the October 2000 offering of New Power shares or the February 2001 offering of Enron notes, as plaintiffs contend in paragraphs 765 and 766 of the Complaint. Indeed, elsewhere in the Complaint, plaintiffs fail to identify Lehman in allegations describing the banks that allegedly participated in those offerings. (*See* Compl. ¶¶ 48-49, 288.) Plaintiffs also identify other offerings dating back to November 1993 (Compl. ¶ 765), but those substantially predate the alleged Class Period, and plaintiffs do not appear to base any of their claims on those offerings. To the extent that they do, however, any such claims are time-barred, as the offerings occurred more than three years before plaintiffs first named Lehman as a defendant in this action on April 8, 2002. *See Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350, 364 (1991); 15 U.S.C. § 78i(e) (1997) ("No action shall be maintained . . . unless brought within one year after the discovery of the facts constituting the violation and within three years after such violation.").

condition and its prospects." (*Id.* ¶ 769 (emphasis omitted).) The Complaint selectively quotes from a number of those reports. (*Id.* ¶¶ 125, 143, 150, 206, 231, 254, 270, 287, 303, 312, 322, 338, 341, 347, 379, 381.)[3] The Lehman analyst quotations generally consist of opinions, recommendations to buy Enron stock, and information reported by Enron on which the opinions and recommendations are based. (*Id.* ¶¶ 143 ("we conclude that," "we expect"), 150 ("The payoff from this positioning is just beginning."), 206 ("Given Our Early Assessment," "Enron . . . Expects"), 232 ("Jeff Skilling presented another impressive picture," "In our view," "very impressive," "We also expect"), 270 ("Just Beginning To Harvest Crop"), 303 ("attractive entry point"), 312 ("Has Bottomed Out," "lead us to believe," "will rekindle interest"), 338 ("In Our View," "Beginning To Roll Downhill," "We continue to view"), 341 ("Has Bottomed Out," "lead us to believe," "will rekindle interest"), 347 ("We Don't Expect," "We Would Be A Buyer," "We Continue To Think"), 379 ("Stock will recover"), 381 ("We heard nothing to sway us from our conviction").) They are scattered throughout 144 pages of the Complaint, where they are interspersed with hundreds of other alleged statements of many other defendants. (*Id.* ¶¶ 109-393.) Nowhere in the Complaint do plaintiffs identify a particular statement by a Lehman analyst and state the specific facts that rendered *that statement* false and misleading when made. Instead, at arbitrary points throughout plaintiffs' recitation of the hundreds of alleged representations, they summarily proclaim that all of the preceding statements "were false and misleading when made," and recite equally conclusory allegations of what plaintiffs claim were the "true but concealed facts." (*Id.* ¶¶ 155, 214, 300, 339, 390.)

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[3] Two of these reports were issued more than three years before Lehman was added as a party to this action on April 8, 2002. (*See* Compl. ¶¶ 125 (12/9/98 report), 143 (4/7/99 report).) Thus, any claims based on them are time-barred. *See Lampf*, 501 U.S. at 364; 15 U.S.C. § 78i(e).

E. Lehman's Alleged Loans To Enron

Finally, plaintiffs allege that Lehman "engaged in transactions with Enron to disguise loans to Enron and help Enron falsify its true financial condition, liquidity and creditworthiness." (*Id.* ¶ 763.) Nowhere in the Complaint, however, is a single such loan transaction identified, let alone shown to be part of a fraudulent scheme. Elsewhere in the Complaint, plaintiffs describe several transactions that they characterize as disguised loans by *other* bank defendants (*id.* ¶¶ 559, 568, 664-668, 684, 706, 743), but nowhere is Lehman mentioned as a participant in any such transaction.

Plaintiffs allege as well that "Lehman Brothers was lending millions to Enron," even though it allegedly knew that Enron was financially unstable. (*Id.* ¶¶ 767, 18.) The Complaint does not, however, identify a single loan, or explain how such lending constituted actionable fraud (nor could it, of course). Lehman supposedly made these loans despite knowing that Enron was not creditworthy because it "was limiting its own risk in this regard, as it knew that either with its help or the help of other banks which were part of the scheme, so long as" Enron's stock price stayed afloat, Lehman could earn interest payments and investment banking fees by doing future business with Enron. (*Id.* ¶ 767.) Once again, the Complaint provides no specific facts to support that assertion, nor even any coherent explanation why Lehman would risk default on these unspecified loans if it knew the allegedly "true . . . facts."

F. Plaintiffs' Conclusory Allegations Of Lehman's Scienter

Rather than pleading the specific facts required by statute and case law to establish scienter, plaintiffs rely on the boilerplate allegation — which they repeat verbatim for each other "bank" defendant — that Lehman "knew that Enron was falsifying its publicly reported financial results and that its true financial condition was much more precarious than was publicly known." (*Id.* ¶ 771; *see also id.* ¶¶ 670, 689, 713, 733, 748, 760, 784, 798.) As it does with the other bank

defendants, the Complaint alleges in conclusory fashion that Lehman "obtained this knowledge due to its access to Enron's internal business and financial information as Enron's lead lending bank, as well as its intimate interaction with Enron's top officials which occurred virtually on a daily basis." (*Id.*) The Complaint also repeats verbatim as to Lehman the rote allegation that "top officials of the bank constantly interacted with top executives of Enron, *i.e.*, Lay, Skilling, Causey, McMahon or Fastow, on an almost a [sic] daily basis . . . discussing Enron's business, financial condition, financial plans, financing needs, its partnerships and SPEs and Enron's future prospects." (*Id.* ¶ 763.)

Not once does the Complaint identify a loan in which Lehman was involved, let alone allege facts establishing that Lehman was Enron's "lead lending bank." Nor does it say specifically (1) what concrete facts Lehman knew, (2) who at Lehman knew them, or (3) how and when they were learned. No credit analysis or due diligence report or other document, and no communication or meeting of any kind, is identified, nor is any person with such knowledge. The Complaint just asserts that Lehman "knew" there was a fraudulent scheme simply because it provided banking services to Enron. The law requires more.

Plaintiffs further allege that all of "the banks" involved in Enron and Enron affiliate securities offerings "knew" that Enron's reported financial statements — and its statements about its financial and credit risk contained in the Offering Documents and Enron SEC filings they incorporated — were false and misleading because they and the law firm defendants "structured the underlying deals and the banks acted as counterparties to Enron's bogus hedging transactions through the LJM partnerships and Raptors." (*Id.* ¶ 617.) Again, the Complaint reveals no specific facts to support that conclusory charge as to Lehman. The Complaint identifies no "deals" structured by Lehman, and no "bogus hedging transactions" in which Lehman was a

counter-party. Nor does it cite any specific document or other source of information showing that Lehman had any knowledge that LJM2 was being used or would be used for fraudulent purposes of concealing Enron's true financial condition.[4]

Plaintiffs' allegations regarding the supposed knowledge of Lehman's analysts are also without substance. Nowhere is there an allegation of a single fact demonstrating how, notwithstanding the "Chinese Wall" that prevents the flow of information from Lehman's investment bankers to its analysts, Lehman's analysts learned any of the information that supposedly rendered statements in their reports false and misleading. Nowhere is there an allegation detailing what information they learned and when and how they learned it. Plaintiffs instead recite the same allegations they make for every bank defendant that "[t]here was no so-called 'Chinese Wall' to seal off the Lehman Brothers securities analysts from the information which Lehman Brothers obtained rendering commercial and investment banking services to Enron," and that "even if some restrictions on the information made available to Lehman Brothers' securities analysts existed, that unilateral and self-serving action was insufficient to prevent the imputation of all knowledge (and scienter)" to the analysts. (*Id.* ¶ 764.)[5] Plaintiffs fail to allege a single specific fact substantiating the alleged nonexistence or insufficiency of the Chinese Wall at Lehman or demonstrating when and how the Chinese Wall was breached and

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[4] Plaintiffs identify only one document received by Lehman — a private placement memorandum circulated by Merrill Lynch to potential investors in LJM2. (*Id.* ¶¶ 25, 646, 647.) The memorandum allegedly "emphasized [defendant] Fastow's position as Enron's CFO, . . . that LJM2's day-to-day activities would be managed by Enron insiders Fastow, Kopper, and Glisan" (*id.* ¶ 646), and that LJM2 was expected to benefit from its relationship with Enron and provide significant investment returns (*id.* ¶¶ 25-26, 461). Plaintiffs allege no information in the memorandum that possibly could have put Lehman on notice that LJM2 was used, or was intended to be used, to inflate Enron's profits, to conceal Enron's losses or debts, or to give a false appearance that Enron's credit or financial risks were hedged.

[5] Plaintiffs' characterization of the Chinese Wall at Lehman as "insufficient to prevent the imputation of all knowledge to the analysts" is not even a factual allegation but rather a legal conclusion.

what specific information was communicated from Lehman's investment bankers to Lehman's analysts. In fact, plaintiffs do not allege that any Lehman analyst actually *did* know the "true . . . facts."

Lacking any facts establishing Lehman's knowledge, plaintiffs are reduced to alleging that Lehman had a motive for assisting the Enron defendants' alleged fraud — to earn more fees from Enron. (*Id.* ¶¶ 767, 769.) Plaintiffs are thus claiming, without citation to a single substantiating fact, that Lehman participated in the fraud in order to do future business with Enron, a shop-worn theory that has been repeatedly rejected.

III. ARGUMENT

A. Plaintiffs Have Failed To State A Claim Against Lehman For Violations Of Sections 10(b) And 20(a) And Rule 10b-5.

In their First Claim for Relief, plaintiffs assert claims against Lehman under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78t(a), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated under Section 10(b). To state a Section 10(b)/Rule 10b-5 claim, a plaintiff must allege that defendant: (1) made a misstatement or omission; (2) of a material fact; (3) with scienter (*i.e.*, the intent to defraud); (4) on which plaintiff relied; and (5) that proximately caused plaintiff's injury. *See, e.g., Lovelace v. Software Spectrum Inc.*, 78 F.3d 1015, 1018 (5th Cir. 1996). Plaintiffs' Section 10(b) and Rule 10b-5 claims fail as to Lehman because they are not predicated on alleged false or misleading statements by Lehman. Instead the alleged conduct by Lehman at best constitutes aiding and abetting the Enron defendants' alleged securities fraud. Even where they purport to base their claims on alleged false and misleading statements, moreover, plaintiffs' claims fail for two reasons: they do not plead specific facts giving rise to a strong inference of scienter as to each

such alleged statement, and they do not plead the statements themselves with the particularity required by Rule 9(b) and the PSLRA.

1. Plaintiffs' Aiding And Abetting Allegations Fail To State A Claim.

a. There Is No Aiding And Abetting Liability Under Section 10(b) And Rule 10b-5.

In *Central Bank*, 511 U.S. at 180, the Supreme Court abolished the private cause of action for aiding and abetting under Section 10(b) and Rule 10(b)-5. *See also Melder*, 27 F.3d at 1104 n.9. The Court held that Section 10(b) "does not itself reach those who aid and abet . . .[but] prohibits only the making of a material misstatement (or omission) or the commission of a manipulative act." *Central Bank*, 511 U.S. at 177. The Court rejected the argument that the phrase "directly or indirectly" in Section 10(b) covers aiding and abetting liability, because such a construction of the statute would extend liability to those "who do not engage in the proscribed activities at all, but who give a degree of aid to those who do." *Id.* at 176. The Court explained:

> Our reasoning is confirmed by the fact that [plaintiffs] would impose 10b-5 aiding and abetting liability when at least one element critical for recovery under 10b-5 is absent: reliance. *A plaintiff must show reliance on the defendant's misstatement or omission to recover under 10b-5.* Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable without any showing that the plaintiff relied upon the aider and abettor's statements or actions. Allowing plaintiffs to circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery mandated by our earlier cases.

Id. at 180 (emphasis added, citations omitted).

Following *Central Bank*, three appellate courts have held that a secondary actor cannot be a primary violator under Section 10(b) and Rule 10b-5 unless it actually makes the material misstatement or omission — anything short of such conduct is merely non-actionable aiding and abetting. *See Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998); *Anixter v. Home-*

Stake Prod. Co., 77 F.3d 1215, 1226 & n.10 (10th Cir. 1996); *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001).[6] Under this view, which comports completely with *Central Bank* and has come to be known as the "bright line" test, plaintiffs' Section 10(b) and Rule 10b-5 claims must fail.

b. The Complaint Predominately Alleges Aiding And Abetting By Lehman.

Despite obvious efforts to plead around *Central Bank*, the main thrust of plaintiffs' allegations about Lehman is that it aided and abetted the Enron defendants in carrying out a "scheme to defraud." (Compl. ¶ 108.) Not only is this legally meritless theory the overarching theme of the Complaint, but virtually all of the individual allegations against Lehman fall directly into this category. They include the allegations that Lehman (1) invested in LJM2, (2) provided Enron access to the capital markets by underwriting securities offerings, (3) "helped" Enron (in some unidentified way) falsify its financial statements and misrepresent its financial condition, and (4) made unspecified loans to Enron. These are classic aiding and abetting allegations. Nothing could make this clearer than plaintiffs' statement that their fundamental claim against Lehman is that it "*participated in the scheme to defraud . . . by rendering all the above [banking] services to Enron.*" (Compl. ¶ 108 (emphasis added).)

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[6] Despite *Central Bank's* unequivocal language to the contrary, the Ninth Circuit (in a footnote) has held that the secondary actor need not actually make the material misrepresentation or omission in order to be a primary violator under Section 10(b) and Rule 10b-5. According to the Ninth Circuit, it is enough that the secondary actor participate in the fraud in some "substantial" manner. *See In re Software Toolworks Inc. Sec. Litig.*, 50 F.3d 615, 628 n.3 (9th Cir. 1995) (holding that accountants may be primarily liable for statements made by others where the accountants reviewed the statements and played a significant role in the drafting and editing of the statement). This erroneous minority view, which has come to be known as the "substantial participation" test, should not be followed by this Court. *See, e.g., Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997) (rejecting "substantial participation" test); *Anixter*, 77 F.3d at 1226-27 (same). In any event, plaintiffs have failed to allege the degree of participation by Lehman in the alleged fraudulent scheme necessary to hold Lehman liable as a primary violator even under that standard. Plaintiffs nowhere allege that Lehman played any role whatsoever, much less a "substantial" one, in the drafting of any of Enron's allegedly false and misleading statements.

Plaintiffs' attempt to manufacture a claim from Lehman's investment in LJM2 is an obvious aiding and abetting claim at best. Plaintiffs allege that unidentified Lehman executives were "permitted to invest $10 million in LJM2 – a reward to Lehman Brothers for its participation in the [fraudulent] scheme – to facilitate the financing of that critical vehicle, and to put money up early – on or about 12/2/299 [sic] – so that Enron could do deals in late 99 to artificially inflate Enron's reported 99 profits." (Compl. ¶ 770 (emphasis omitted).) This allegation, which does not involve a false or misleading statement by Lehman, cannot serve as the basis of a Section 10(b) or Rule 10b-5 claim. *See Shapiro,* 123 F.3d at 720.

The same is true of plaintiffs' allegations that Lehman's underwriting provided Enron with access to the capital markets and thereby helped Enron perpetuate its "Ponzi scheme," and that Lehman made loans — "disguised" or not — to Enron. (Compl. ¶¶ 763, 765-767.) Underwriting and lending activities cannot, in and of themselves, give rise to Section 10(b) liability. *See, e.g., Interallianz Bank AG v. Nycal Corp.*, No. 93 CIV. 5024(RPP), 1994 WL 177745, at *8 n.7 (S.D.N.Y. May 6, 1994) (no 10(b) violation without allegation that lender went "beyond the normal conduct and interests of a lender"); *Jett v. Sunderman*, 840 F.2d 1487, 1493 (9th Cir. 1988) (routine commercial financing transactions do not violate 10(b)); *Cogan v. Triad Am. Energy*, 944 F. Supp. 1325, 1328-31 (S.D. Tex. 1996) (an investor cannot state a claim based on lending to issuer); *Sloane Overseas Fund, Ltd. v. Sapiens Int'l Corp.*, 941 F. Supp. 1369, 1377 (S.D.N.Y. 1996) (the provision of offering manager and underwriter services could not support claim under Section 10(b)). Otherwise, investment banks and lenders would be automatically liable for the Section 10(b) violations of their corporate customers.[7]

[7] Plaintiffs' contention that the offering documents issued in connection with the securities offerings contained false and misleading statements does not take their claims outside the realm of aiding and abetting. (Compl. ¶¶ 612-41.) Contrary to plaintiffs' legal argument that statements in registration statements and

Finally, the assertion that Lehman "*helped* Enron falsify its financial statements and misrepresent its financial condition" (Compl. ¶¶ 762 (emphasis added)) speaks for itself as being an allegation of aiding and abetting. Indeed, plaintiffs cannot help but describe *every* aspect of Lehman's alleged "role" or "participation" in the fraudulent scheme, including its analyst reports, in the aiding and abetting language of "help[ing]." Lehman, plaintiffs allege, "*helped* structure and financed one or more of Enron's illicit partnerships or SPEs"; "*helped* Enron falsify its financial statements and misrepresent its financial condition;" "*helped* Enron and its related entities raise" capital; "knew that either with its *help or the help* of other banks" Enron could continue its scheme; "stood to continue to collect . . . huge fees . . . so long as it *helped* perpetuate the Enron Ponzi scheme"; "*help*[*ed*] [Enron] structure and finance the critical LJM2 SPE"; and "*helped* to artificially inflate the trading price of Enron's publicly traded securities" by issuing false and misleading analyst reports. (Compl. ¶¶ 762, 763, 767, 770, 772 (bold emphasis omitted, italics added).) Because *Central Bank* makes clear that Lehman cannot be liable for allegedly "help[ing]" the Enron defendants carry out a "fraudulent scheme," plaintiffs' own words doom their Section 10(b) and Rule 10b-5 claims against Lehman.[8]

(continued...)

prospectuses "are statements made by Lehman . . . as an underwriter" (Compl. ¶ 768), only specific statements shown in fact to be attributable to an underwriter can form the basis for liability. *See In re VMS Sec. Litig.*, 752 F. Supp. 1373, 1394 n.18 (N.D. Ill. 1990) (allegations that underwriters were responsible for preparing or issuing the prospectuses were not supported by allegations of fact, and amounted at most to aiding and abetting allegations); *Zishka v. Am. Pad & Paper Co.*, No. 3:98-CV-0660-M, 2000 WL 1310529, at *3 (N.D. Tex. Sept. 13, 2000) (dismissing section 10(b) claim against underwriters for plaintiffs' failure to plead facts showing underwriters' participation in making false statements in the registration statement); *Eickhorst v. Am. Completion & Dev. Corp.*, 706 F. Supp. 1087, 1092 (S.D.N.Y. 1989) (dismissing under 9(b) for failure to allege that defendant broker was involved in preparing or drafting challenged offering materials). Lacking any specific facts showing that Lehman was actually responsible for any specific statements in any of the offering documents, plaintiffs' claims cannot stand. Even if any of the representations in the offering documents could be attributed to Lehman, moreover, plaintiffs have not even specifically identified each allegedly false or misleading statement in each of the offering documents, much less specified the reasons why the statements were allegedly false or misleading.

[8] That plaintiffs couch their claims in terms of "participat[ion]" in the Enron defendants' "fraudulent scheme" does not help but, rather, further undercuts their claims. *See, e.g., Lemmer v. Nu-Kote Holding, Inc.*, No.

2. The Complaint Fails To Plead Specific Facts Showing That Lehman Is Liable For Any Alleged False Or Misleading Statements.

a. Plaintiffs' Claims Are Subject To Strict Pleading Requirements.

(1) The Pleading Requirements Of Rule 9(b)

Rule 9(b) requires that "[i]n all averments of fraud . . ., the circumstances constituting fraud . . . shall be stated with particularity." Fed. R. Civ. P. 9(b). To comply with Rule 9(b), plaintiffs must allege "the who, what, when, and where" of the alleged fraud. *Williams*, 112 F.3d at 178. "Pleading fraud with particularity in this circuit requires 'time, place and contents of the false representations, as well as the identity of the person making the misrepresentation and what [that person] obtained thereby.'" *In re Azurix Corp. Sec. Litig.*, No. H-00-4034, 2002 WL 562819, at *12 (S.D. Tex. Mar. 21, 2002) (Lake, J.) (brackets in original) (quoting *Williams*, 112 F.3d at 177). Plaintiffs "must plead specific facts, not mere conclusory allegations . . . ." *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1067 (5th Cir. 1994) (quotation, citation omitted). *See also Jefferson v. Lead Indus. Ass'n, Inc.*, 106 F.3d 1245, 1250 (5th Cir. 1997); *Collmer v. U.S. Liquids, Inc.*, No. H-99-2785 *et al.*, 2001 U.S. Dist. LEXIS 23518, at *4 n.2

(continued...)

3:98-CV-0161-L, 2001 U.S. Dist. LEXIS 13978, at *25-26 (N.D. Tex. Sept. 6, 2001) (dismissing 10(b) "scheme to defraud" claim); *Valence Tech.*, 1996 WL 37788, at *10-11 (dismissing Section 10(b) claim based on allegations of underwriter's participation in fraudulent scheme as impermissible claim for aiding and abetting); *Strassman v. Fresh Choice, Inc.*, No. C-95-20017 RPA, 1995 WL 743728, at *17 (N.D. Cal. Dec. 7, 1995) (holding claim against underwriter for alleged participation in fraudulent scheme "barred by *Central Bank*"); *In re Silicon Graphics, Inc. Sec. Litig.*, 970 F. Supp. 746, 762 (N.D. Cal. 1997) (dismissing claim against underwriters based on fraudulent scheme allegations as "thinly disguised attempt to avoid . . . *Central Bank*"), *aff'd*, 183 F.3d 970 (9th Cir. 1999); *Stack v. Lobo*, 903 F. Supp. 1361, 1374 (N.D. Cal. 1995) (dismissing claim against corporate insiders based on fraudulent scheme allegations as "thinly disguised attempt to avoid . . . *Central Bank*").

(S.D. Tex. Jan. 23, 2001) (Harmon, J.); *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 419-20 (5th Cir. 2001).[9]

In addition, "[p]laintiffs must explain why the statements were fraudulent [and] . . . set forth an explanation as to why the disputed statement was untrue or misleading when made." *McNamara v. Bre-X Minerals Ltd.*, 57 F. Supp. 2d 396, 404 (E.D. Tex. 1999) (quotations, citations omitted). "'This can be done most directly by pointing to inconsistent contemporaneous statements or information (such as internal reports) which were made by or available to the defendants.'" *Id.* (quoting *In re Glenfed, Inc. Sec. Litig.*, 42 F.3d 1541, 1548 (9th Cir. 1994)). *See also Azurix*, 2002 WL 562819, at *13 (holding that plaintiffs must explain why the statements were fraudulent by delineating who confirmed the allegations of fraud, what positions in the company these employees held, and which exact misrepresentations they were confirming).

(2) The Pleading Requirements Of The PSLRA

The PSLRA imposes additional and reinforcing requirements for pleading securities fraud; when any of these requirements is not met, the complaint must be dismissed. 15 U.S.C. § 78u-4(b)(3) (1997). *First*, the PSLRA mandates that a complaint "shall *specify each* statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed." 15 U.S.C. § 78u-

[9] "Rule 9(b) is designed to further three goals: (1) providing a defendant fair notice of plaintiff's claim, to enable preparation of defense; (2) protecting a defendant from harm to his reputation or goodwill; and (3) reducing the number of strike suits." *DiVittorio v. Equidyne Extractive Indus., Inc.*, 822 F.2d 1242, 1247 (2d Cir. 1987) (citation omitted). Rule 9(b) "prevents the filing of a complaint as a pretext for the discovery of unknown wrongs and protects potential defendants — especially professionals whose reputations in their fields of expertise are most sensitive to slander — from the harm that comes from being charged with the commission of fraudulent acts." *Semegen v. Weidner*, 780 F.2d 727, 731 (9th Cir. 1985).

4(b)(1) (1997) (emphasis added). "This heightened pleading standard 'serves an important screening function in securities fraud suits.'" *Bre-X Minerals*, 57 F. Supp. 2d at 404 (quoting *Melder*, 27 F.3d at 1100).

Second, the PSLRA requires that, "with respect to *each* act or omission alleged," the complaint "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2) (1997) (emphasis added). To maintain an action under Section 10(b) and Rule 10b-5, therefore, a plaintiff must plead *specific* facts that give rise to a "*strong* inference" of scienter. *Nathenson*, 267 F.3d at 407, 411-12. Scienter is a mental state embracing intent to deceive, manipulate or defraud. *Bre-X Minerals*, 57 F. Supp. 2d at 404 (quoting *Tuchman*, 14 F.3d at 1067).

Simple allegations that defendants had fraudulent intent are insufficient to plead scienter. *Azurix*, 2002 WL 562819, at *21. Scienter is established by setting forth facts supporting a strong inference that defendants acted with knowledge or severe recklessness in making misrepresentations. *In re Sec. Litig. BMC Software, Inc.*, 183 F. Supp. 2d 860, 866 n.15 (S.D. Tex. 2001) (citation omitted).[10] "[R]ote conclusory allegations that the defendants 'knowingly did this' or 'recklessly did that' fail to meet the heightened pleading requirements of Rule 9(b)." *Lovelace*, 78 F.3d at 1019. *See also Azurix*, 2002 WL 562819, at *24; *Nathenson*, 267 F.3d at 419-20; *Melder*, 27 F.3d at 1102-03. Similarly, the standard is not met by using subsequent disclosures of negative information; such facts do not show that "defendants knew

[10] Recklessness has been defined as "limited to those highly unreasonable omissions or misrepresentations that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it." *Nathenson*, 267 F.3d at 408 (quotation, citation omitted). *See also BMC Software*, 183 F. Supp. 2d at 869 n.18 (same).

the statements were materially false or misleading *when made*." *Azurix*, 2002 WL 562819, at *23.

Allegations of motive and opportunity do not establish scienter under the PSLRA. *See Nathenson*, 267 F.3d at 412 ("[I]t would seem to be a rare set of circumstances indeed where those allegations alone are both sufficiently persuasive to give rise to a scienter inference of the necessary strength and yet at the same time there is no basis for further allegations also supportive of that inference."); *Zishka v. Am. Pad & Paper Co.*, No. 3:98-CV-0660-M, 2001 U.S. Dist. LEXIS 21206, at *8 (N.D. Tex. Dec. 20, 2001) ("[T]he passage of the PSLRA rendered motive and opportunity pleading alone insufficient for purposes of alleging scienter."); *BMC Software*, 183 F. Supp. 2d at 901 (holding that motive and opportunity allegations would "nearly always" be insufficient). Instead, plaintiffs must state "particularized facts giving rise to a strong inference of scienter." *Nathenson*, 267 F.3d at 412. To do so, plaintiffs must identify the *specific* documents that contained the relevant information and state who received them and when, or plead similarly specific facts concerning meetings or other communications from which knowledge of contrary facts can be strongly inferred. *Coates v. Heartland Wireless Communications, Inc.*, 26 F. Supp. 2d 910, 921 (N.D. Tex. 1998). *See also, e.g., Arazie v. Mullane*, 2 F.3d 1456, 1467 (7th Cir. 1993); *Wilson v. Bernstock*, No. 01-0272 (JEI), 2001 U.S. Dist. LEXIS 22354, at *59 (D.N.J. Jan. 23, 2001); *In re NAHC, Inc. Sec. Litig.*, No. 00-4020, 2001 U.S. Dist. LEXIS 16754, at *64 (E.D. Pa. Oct. 17, 2001); *In re Boston Tech., Inc. Sec. Litig.*, 8 F. Supp. 2d 43, 57-58 (D. Mass. 1998).

b. Plaintiffs Fail To Plead Specific Facts Giving Rise To A Strong Inference Of Scienter As To Each False Or Misleading Statement.

(1) Plaintiffs' Conclusory Allegations That Lehman "Knew" Of The Fraudulent Scheme Are Wholly Inadequate.

Plaintiffs' conclusory allegations that Lehman knew of the alleged fraud from its banking contacts with Enron (Compl. ¶¶ 763, 771) fail to satisfy the PSLRA's heightened pleading standard. Even in the context of knowledge within a single company, general allegations that adverse information was transmitted through efficient and regular internal reports "may speak to the question of *how* defendants might have known what they allegedly knew, but [they are insufficient] absent some indication of the specific factual *content* of any single report generated by the alleged reporting system. . . ." *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1224, n.38 (1st Cir. 1996). For example, in *BMC Software*, the plaintiffs alleged scienter based on defendants' executive positions, their involvement in the day-to-day management of the business, their access to internal corporate documents, conversations with corporate officers and employees, and their attendance at management and board meetings. 183 F. Supp. 2d at 870, 885, 887, 915-16. This Court found such allegations insufficient, holding that plaintiffs must "provide details about alleged negative internal reports, when they were prepared, who prepared them, their content, the sources from whom plaintiffs obtained such information, etc." *Id.* at 887. (citation omitted). "Merely alleging that the defendants knew or had access to information by virtue of their board or managerial positions is not sufficient to plead scienter." *Azurix*, 2002 WL 562819, at *23; *see also, e.g., Marks v. Simulation Scis.*, No. CV98546GLT, 2000 WL 33115589, at *2 (C.D. Cal. Feb. 28, 2000) (intimate access to internal documents and personnel does not show defendant knew its analysts' statements to be false).

Thus, generalized allegations that underwriters had access to, and close relationships with, top corporate executives and directors, are insufficient. *E.g., In re Stratosphere Corp. Sec.*

Litig., 1 F. Supp. 2d 1096, 1122 (D. Nev. 1998). Rather, the Complaint must specify actual documents, meetings, and communications, their content, who was involved, and when. *Id.*; *see also Marks*, 2000 WL 33115589, at *2-3 (holding that nonspecific allegations of underwriter access to corporate officials and information, virtually identical to those here, failed to raise an inference of scienter); *In re Landry's Seafood Rest., Inc. Sec. Litig.*, No. H-99-1948, slip op. at 66 (S.D. Tex. Feb. 20, 2001) (Harmon, J.) ("Plaintiffs fail to provide any details or identify specifically what kind of information, when it was conveyed, by whom and to whom."); *see also Fisher v. Offerman & Co.*, No. 95 Civ. 2566 (JGK), 1996 WL 563141, at *7 (S.D.N.Y. Oct. 2, 1996); *In re Indep. Energy Holdings PLC Sec. Litig.*, 154 F. Supp. 2d 741, 764 (S.D.N.Y. 2001). The Complaint abjectly fails to plead these required specific facts. "Not a single report, memorandum, meeting minute, or like item is referred to or specified in the Complaint" to support the allegation that Lehman knew that Enron was misrepresenting its financial condition as alleged in the Complaint. *Boston Tech.*, 8 F. Supp. 2d at 58.

Even worse are plaintiffs' undifferentiated allegations that, as a result of having provided underwriting and commercial lending services for Enron, all the "banks knew" that "Enron had set up the LJM2 vehicle . . . to engage in . . . self-dealing transactions [allowing] Enron to generate artificial profits and conceal its true debt," and that "Enron's actual financial condition . . . [was] far worse than what was being publicly disclosed or presented . . . ." (Compl. ¶ 651; *see also id.* ¶¶ 619, 621, 624, 627, 628.) It does not follow from the mere performance of underwriting services that Lehman knew any of these things. The Complaint provides no specific facts showing that Lehman knew any of the alleged facts regarding LJM2 as a result of its underwriting and lending, identifies neither relevant documents nor communications, nor anyone at Lehman who knew these things, let alone when, and does not even identify a single

transaction that Lehman knew was intended to generate artificial profits for Enron.[11] Plaintiffs' allegations are fatally deficient. *See Wenger v. Lumisys, Inc.*, 2 F. Supp. 2d 1231, 1250 (N.D. Cal. 1998); *see also Melder*, 27 F.3d at 1103-04.

The Complaint's failure to plead scienter is doubled in the case of the analyst statements by plaintiffs' failure to allege — let alone plead specific facts showing — that the *analysts* issuing the reports had contemporaneous knowledge of facts contradicting their statements. Plaintiffs' conclusory attempt to negate the "Chinese Wall," which they repeat verbatim for every bank defendant, is patently insufficient. Plaintiffs must identify *specific* documents or similar contemporaneous facts showing that analyst statements were made with knowledge that they were false. *In re Valence Tech. Sec. Litig.*, No. 95-20459 JW, 1996 WL 37788, at *7-8, 12 (N.D. Cal. Jan. 23, 1996); *In re Oak Tech. Sec. Litig.*, No. 96-20552 SW, 1997 WL 448168, at *14 (N.D. Cal. Aug. 1, 1997). Conclusory allegations that analysts possessed such information, or that they learned it from their firms' underwriting activities, will not do. *Marks*, 2000 WL 33115589, at *2; *In re Autodesk, Inc. Sec. Litig.*, 132 F. Supp. 2d 833, 844 (N.D. Cal. 2000); *Stratosphere*, 1 F. Supp. 2d at 1121-22; *Wenger*, 2 F. Supp. 2d at 1251.[12]

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[11] The LJM2 offering memorandum that Lehman received does not supply this missing puzzle piece. Plaintiffs do not allege that the memorandum revealed any of these alleged facts. They allege only that it stressed the involvement of Enron executives in LJM2 and high anticipated investment returns. (Compl. ¶¶ 25-26, 461, 646.) This certainly implies nothing about the use of LJM2 to hide Enron losses or inflate its profits.

[12] In addition, the quoted analyst statements generally are "forward-looking statements" as defined in the PSLRA's "safe harbor" sections. *See* 15 U.S.C. §§ 77z-2(i)(1), 78u-5(i)(1) (1997); *Harris v. Ivax Corp.*, 182 F.3d 799, 806 (11th Cir. 1999) (holding that statements including present-tense observations and assumptions are forward-looking); *Fellman v. Electro Optical Sys. Corp.*, No. 98 Civ. 6403 (LB), 2000 U.S. Dist. LEXIS 5324, at *12-18 (S.D.N.Y. April 25, 2000) (dismissing claims against analysts). The safe harbor imposes a heightened "actual knowledge" standard of scienter for claims based on such statements. 15 U.S.C. §§ 77z-2(c)(1)(B), 78u-5(c)(1)(B). Thus, to survive dismissal, plaintiffs' Complaint must plead facts meeting this standard as to any such statements. *See* 15 U.S.C. § 78u-4(b)(2) (1997). It certainly does not do so in Lehman's case.

(2) Plaintiffs' Motive And Opportunity Allegations Permit No Inference Of Scienter.

Plaintiffs' back-up theory is no better. Failing to cite any specific facts showing knowledge, they attempt to plead scienter by alleging that Lehman was "willing to engage and participate in the ongoing fraudulent scheme" because it was earning "interest payments, syndication fees and investment banking fees . . . and stood to continue to collect these huge fees on an annual basis going forward so long as it helped perpetuate the Enron Ponzi scheme." (Compl. ¶ 767 (emphasis omitted); *see also id.* ¶ 770.) In other words, Lehman allegedly had a generic financial motive. Motive and opportunity allegations do not, however, establish scienter. *Nathenson*, 267 F.3d at 412.

Indeed, the Fifth Circuit has rejected as "a mockery of Rule 9(b)" similar allegations that securities underwriters had motives to collect fees, because it would "effectively eliminat[e] the scienter requirement . . . since all underwriters are, of course, fee seekers." *Melder*, 27 F.3d at 1104. Other courts agree that allegations of underwriters' financial motives are not adequate. *Kalnit v. Eichler*, 264 F.3d 131, 140 (2d Cir. 2001) (holding allegations of financial motives inadequate); *Vogel v. Sands Bros. & Co.*, 126 F. Supp. 2d 730, 739 (S.D.N.Y. 2001) (holding that allegations of "desire to realize greater transaction fees and [underwriter's] close relationship with [issuer] are insufficient to show an improper motive"); *Bre-X Minerals*, 57 F. Supp. 2d at 405 ("Plaintiffs do not sufficiently allege motive by making generic allegations that the defendant had a financial interest in carrying out the alleged fraud.") (citation omitted); *Wenger*, 2 F. Supp. 2d at 1251-52; *Stratosphere*, 1 F. Supp. 2d at 1122 (holding that investment bankers' alleged motives of inflating stock price, market-making, and earning higher fees were inadequate because they "are possessed by every securities analyst or underwriter firm"); *Chan v.*

Orthologic Corp., No. 96-1514 PHX RCV, 1998 WL 1018624, at *23 (D. Ariz. Feb. 5, 1998) (underwriting commissions without more are not sufficient evidence of motive).[13]

Even assuming that motive and opportunity allegations sufficed to plead scienter, plaintiffs also have failed to allege opportunity. Opportunity requires not only access to channels of communication to disseminate false and misleading information but "access to *specific* non-public, internal information regarding the allegedly false and misleading statements." *Bre-X Minerals*, 57 F. Supp. 2d at 405 (quotation, citation omitted) (emphasis added). Plaintiffs have not alleged any specific facts at all to show that Lehman had such access. (*See* Compl. ¶¶ 70, 617, 619, 650, 651, 762-63, 767-68, 771, 994) (alleging access to and knowledge of information without identifying who was involved, when/where it occurred, what was learned).)

(3) Plaintiffs' Scienter Allegations Are Implausible.

The scienter allegations against Lehman are also deficient because they attribute to Lehman economically irrational behavior — behavior *contrary* to its own interests. The Complaint asserts that Lehman was "lending millions to Enron" at the same time it supposedly knew that Enron was financially unsound and at continual risk of imploding. (Compl. ¶¶ 18, 767.) Plaintiffs' allegation that Lehman learned this *in the process* of conducting lending due diligence (*id.* ¶ 771) and still — or even *as a result* — loaned Enron "millions of dollars," is utterly implausible. No lender would behave this way. A securities fraud claim cannot be based on such illogical allegations. *Kalnit*, 264 F.3d at 140-41 ("[w]here plaintiff's view of the facts defies economic reason, [it] does not yield a reasonable inference of fraudulent intent," let alone

[13] In fact, allegations that banking and professional fees created a motive for fraud did not plead scienter even *before* the PSLRA was enacted. *See DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990); *Geiger v. Solomon-Page Group, Ltd.*, 933 F. Supp. 1180, 1189-91 (S.D.N.Y. 1996); *In re Software Toolworks, Inc. Sec. Litig.*, 789 F. Supp. 1489, 1499 n.16 (N.D. Cal. 1992), *aff'd in relevant part*, 50 F.3d 615 (9th Cir. 1995).

a "strong" one) (quotation, citation omitted) (brackets in original); *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990) ("People sometimes act irrationally, but indulging ready inferences of irrationality would too easily allow the inference that ordinary business reverses are fraud. One who believes that another has behaved irrationally has to make a strong case."); *Coates v. Heartland Wireless Communications, Inc.*, 55 F. Supp. 2d 628, 643 (N.D. Tex. 1999) (holding that theory of economic motive that "defies common sense" must be rejected); *Cogan*, 944 F. Supp. at 1331 ("To the extent that the investors imagine that the banker was truly *in pari delicto* with the issuer of the security, the banking transaction was suicidal rather than homicidal.").

c. Plaintiffs Fail To Plead Misstatements Or Omissions By Lehman With The Particularity Required By Rule 9(b) And The PSLRA.

The Complaint not only fails to plead scienter but also fails to plead specific facts showing that Lehman made any false or misleading statements. Plaintiffs scatter quotations from various Lehman analyst reports throughout pages 110-254 of their Complaint amidst hundreds of alleged representations of other defendants and third parties, and then proclaim *all* of the representations to be "false and misleading" based on a litany of "true but concealed facts." (Compl. ¶¶ 155, 214, 300, 339, 390.) Nowhere does the Complaint explain which parts of each quoted Lehman analyst report were false or misleading and why. Nor do plaintiffs tie any allegedly concealed or contrary facts to any particular statements at the times they were made or allege that any of the statements were material. This type of "puzzle" pleading does not state a claim. *See, e.g., Schiller v. Physicians Res. Group, Inc.*, No. 3:97-CV-3158-L, 2002 WL 318441, at *5 n.3 (N.D. Tex. Feb. 26, 2002) (Rule 9(b) not satisfied where plaintiff alleged scores of purportedly false statements but claimed them to be misleading only in several interspersed paragraphs, which failed to match facts with specific statements); *Splash Tech.*, 160 F. Supp. 2d at 1073-75 (defendants and court should not be forced to try to figure out exactly

what are misleading statements and then match them to the reasons they are claimed to be false and misleading); *Chan*, 1998 WL 1018624, at *14 n.11 (plaintiffs cannot list all false and misleading statements then provide a laundry list of reasons why the statements are troublesome); *see also Williams*, 112 F.3d at 178 (dismissing similarly structured "puzzle" complaint, and noting that such pleading is a "mask for an absence of detail").[14]

Plaintiffs' approach is particularly flawed because of the nature of the quoted statements. Virtually all of them are financial forecasts, recommendations, statements of optimism or positive outlook, and information obtained from Enron on which the analysis and recommendations are based. (*See, e.g.*, Compl. ¶¶ 143, 206, 287, 312, 341.) There is no allegation whatsoever, conclusory or otherwise, that the analysts who made the statements did not genuinely hold the opinions and beliefs they expressed, which is the only basis upon which they could be found false or misleading. (Compl. ¶ 29; *id.* at 110-254.) Nor is there any allegation, conclusory or otherwise, that Lehman analysts did not accurately report information provided or disclosed by Enron. To discern from the Complaint why Lehman's analyst statements were false or misleading, or even which ones were material, is impossible. The Complaint simply does not plead these specific facts. *Boston Tech.*, 8 F. Supp. 2d at 64; *Vogel*, 126 F. Supp. 2d at 742-43 (underwriters dismissed because plaintiffs failed to show reports or

[14] This is not merely an aesthetic or stylistic matter, but a substantive one. The length and structure of the Complaint in fact make it virtually impossible to make sense of the allegations against Lehman — or anyone else. To evaluate the legal sufficiency of the Complaint, the Court should perform a "statement-by-statement analysis" to determine whether all required elements such as materiality, falsity, and scienter are pleaded with particularity as to each statement. *See, e.g., Boston Tech.*, 8 F. Supp. 2d at 55-56. When plaintiffs employ the pleading style used here, this task becomes "daunting." *Id.* at 56. The Complaint here defies this thorough statement-by-statement analysis. Indeed, its overlength and structure suggest that the chief drafting objective was to overwhelm the reader and frustrate any attempt to conduct such an analysis. The burden of matching statement with omission improperly falls on the Court with this style of pleading. *Capri Optics Profit Sharing v. Digital Equip. Corp.*, 950 F.2d 5, 8 (1st Cir. 1991).

statements containing facts defendants had access to that would have contradicted defendants' generally optimistic analyst reports).[15]

For all of these reasons, plaintiffs' Section 10(b) and Rule 10b-5 claims must be dismissed.[16]

B. Plaintiffs Fail To State A Claim Against Lehman Under Sections 11 And 15.

In the Third Claim for Relief, certain plaintiffs assert claims against Lehman under Sections 11 and 15 of the Securities Act of 1933, 15 U.S.C. §§ 77k and 77o, in connection with the May 19, 1999, offering of Enron 7.375% Notes and the May 18, 2000, offering of Enron 8.375% Notes and Enron 7.875% Notes. (Compl. ¶ 1006.) Section 11 provides a civil remedy to a person who acquires a security pursuant to a false or misleading registration statement. 15 U.S.C. § 77k(a) (1997). "To prevail on a claim under § 11, a plaintiff must show '(1) that the registration statement contained an omission or misrepresentation and (2) that the omission or misrepresentation was material, that it would have misled a reasonable investor about the nature

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[15] Plaintiffs also quote a 10/1/99 article from *CFO Magazine* that in turn quoted a Lehman Brothers Inc. Senior Vice President commenting on the explanation of "energy stock analysts" as to "how Enron has remade itself so completely." (Compl. ¶ 175.) This allegation is deficient for the same reasons as those concerning the allegations regarding the analysts reports. Plaintiffs fail to explain with any specificity which parts of the statement are false or misleading or why, and fail to plead specific facts showing the speaker's scienter. Moreover, they allege no basis on which the speaker could have owed them a duty in commenting to *CFO Magazine*.

[16] Plaintiffs also fail to state a claim for "control person" liability against Lehman under Section 20(a). Plaintiffs' "First Claim for Relief" lumps all defendants together and charges them with liability under Section 10(b) "and/or" Section 20(a). But plaintiffs never specifically charge Lehman with liability under Section 20(a), and in any event, allege no facts to support such a claim. To establish control, plaintiffs must prove that Lehman possessed direct or indirect "power to direct or cause the direction of management and policies" of whomever Lehman is alleged to have controlled. *Dennis v. General Imaging, Inc.*, 918 F.2d 496, 508-09 (5th Cir. 1990). *See also BMC Software*, 183 F. Supp. 2d at 868 n.17; *Collmer*, 2001 U.S. Dist. LEXIS 23518, at *10 n.7; *In re VMS Sec. Litig.*, 752 F. Supp. 1373, 1399 (N.D. Ill. 1990) (holding that underwriters cannot be liable as controlling persons); *In re Stratosphere Corp. Sec. Litig.*, 1 F. Supp. 2d 1096, 1122 (D. Nev. 1998) (allegations that underwriters had "constant access" to company and its executives and was in "close association" with the company were not sufficient to show control person liability). Plaintiffs do not allege that Lehman controlled any other defendant.

of his or her investment.'" *Collmer*, 2001 U.S. Dist. LEXIS 23518, at * 9 n.6 (quoting *Kaplan v. Rose*, 49 F.3d 1363, 1371 (9th Cir. 1994), *cert. denied*, 516 U.S. 810 (1995)).[17]

The Fifth Circuit has held that "[w]hen 1933 Securities Act claims are grounded in fraud rather than negligence . . ., Rule 9(b) applies," and a claim that fails to meet its requirements should be dismissed. *Melder*, 27 F.3d at 1100 n.6; *see also Lone Star Ladies Inv. Club v. Schlotzsky's Inc.*, 238 F.3d 363, 368-69 (5th Cir. 2001) (reaffirming *Melder*); *Collmer*, 2001 U.S. Dist. LEXIS 23518, at *9 n.6, *104-05 (holding that where Section 11 or Section 12 claims sound in fraud "the plaintiff is required to plead the circumstances constituting the alleged fraud with particularity under Rule 9(b)"); *Azurix*, 2002 WL 562819, at *11 (holding that "claims sound[ing] in fraud . . . must satisfy the strict pleading requirements" of Rule 9(b)).

Plaintiffs have attempted to avoid this problem by disclaiming fraud in their Third Claim for Relief and incorporating only certain preceding paragraphs by reference. (Compl. ¶ 1005.) Despite the confusion that this selective incorporation causes, however, plaintiffs have, in fact, expressly incorporated voluminous allegations of fraud. (*See, e.g.*, Compl. ¶¶ 617, 619, 621, 624, 627, 628 (all purporting to allege scienter and fraud of the bank defendants, and all incorporated by ¶ 1005).) Indeed, plaintiffs expressly incorporate the allegation that "*Lehman Brothers engaged and participated in the scheme to defraud* . . . as described in greater detail in the section of this complaint entitled 'Involvement of Lehman Brothers,'" thus incorporating the

[17] Plaintiffs have failed to plead standing to bring claims under Section 11 because they have not alleged that they purchased any shares in an initial offering. *See, e.g.*, Azurix, 2002 WL 562819, at *25-26 (plaintiffs failed to state actionable Section 11 claim where they had not purchased their shares pursuant to the initial public offering). *See also Ballay v. Legg Mason Wood Walker, Inc.*, 925 F.2d 682, 691 (3d Cir.) (Section 11 deals with initial distributions), *cert. denied*, 502 U.S. 820 (1991); *Brosious v. Children's Place Retail Stores*, 189 F.R.D. 138, 144 (D.N.J. 1999) (aftermarket purchasers do not have standing under Section 11).

entire substance of their fraud claim against Lehman at paragraphs 762-72 as well. (*Id.* ¶¶ 108, 1005 (emphasis added).)

Plaintiffs' attempt to disclaim fraud (*id.* ¶ 1005) is ineffective because it cannot change the reality that the Section 11 claims are based on the same alleged scheme of fraud that underlies their Section 10(b) and Rule 10b-5 claims. *See In re Am. Bank Note Holographics, Inc. Sec. Litig.*, 93 F. Supp. 2d 424, 440 (S.D.N.Y. 2000) (holding that "boilerplate disclaimer of fraud" as to 1933 Act claims was ineffective where they were based on the same "scheme of fraud" allegations underlying Section 10(b) claim); *In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1405 n.2 (9th Cir. 1996) (holding that efforts to disclaim fraud for purposes of Section 11 claims "are unconvincing where the gravamen of the complaint is plainly fraud and no effort is made to show any other basis for the claims levied at the Prospectus"); *see also Shaw*, 82 F.3d at 1223 ("It is the allegation of fraud, not the 'title' of the claim that brings the policy concerns [of pleading with particularity] to the forefront.") (quotation, citation omitted). Indeed, plaintiffs could never successfully disentangle a Section 11 claim from their *hundreds of pages* of allegations of intrinsically fraudulent activity. (*See, e.g.*, Compl. ¶ 393 (alleging that the scheme was "designed and/or perpetrated *only* via the active and knowing participation of" defendants including Lehman (emphasis added).) As shown above, because that alleged fraud is not pleaded with particularity as to Lehman, plaintiffs' Section 11 claims must be dismissed.[18]

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[18] Plaintiffs also allege violations of Section 15 of the Securities Act of 1933, 15 U.S.C. § 77o (1997), although it is again unclear whether they intend to charge Lehman. Recovery under Section 15 must be predicated on liability of a "controlled person" under Sections 11 or 12 of the 1933 Act. *See Azurix*, 2002 WL 562819, at *26 ("Because plaintiffs have failed to adequately plead the violations alleged under the Securities Act and the Exchange Act, the court will also dismiss the § 15 and the § 20(a) claims for failure to adequately allege a primary violation by . . . the 'controlled person.'") (citation omitted); *Gannon v. Continental Ins. Co.*, 920 F. Supp. 566, 576 (D.N.J. 1996) ("Since liability under § 15 of the 1933 Act is premised on liability under § 11 or § 12 that allegation fails as well.") (citation omitted); *In re WRT Energy Sec. Litig.*, No. 96 CIV. 3610 (JFK), 1997 WL 576023, at *7 (S.D.N.Y. Sept. 15, 1997) (same); *In re Delmarva Sec. Litig.*,, 794 F. Supp. 1293, 1310 (D. Del. 1992) (same). The Complaint does not allege that Lehman controlled any liable person and does not adequately plead claims under Section 11. Any

C. The Texas Securities Act Claim Must Be Dismissed.

1. Plaintiff Washington Board Fails To Plead A Sufficient Nexus Between Texas And The Sale Of The Securities.

In the Fourth Claim for Relief, plaintiff Washington Board asserts a claim against Lehman under the Texas Securities Act, Tex. Rev. Civ. Stat. Ann. art. 581-33, in connection with the July 1998 offering of 6.95% Enron notes due July 15, 2028, and 6.40% Enron notes due July 15, 2006. For the Texas Securities Act to apply, there must be a meaningful nexus between the sales of the securities and the State of Texas. *See, e.g, In re Revco Sec. Litig.*, No. 89CV593, 1991 WL 353385, at *13-14 (N.D. Oh. Dec. 12, 1991) (refusing to apply Ohio's blue sky statute where a New York-based underwriter sold the securities of an Ohio-based company to a New York entity); *Allen v. Oakbrook Sec. Corp.*, 763 So. 2d 1099, 1100-01 (Fl. Dist. Ct. App. 1999) (refusing to apply Florida's blue sky statute even though the securities consisted of stock in a company which was incorporated in Florida and had its principal place of business in Florida; "courts considering the issue have uniformly rejected applying one state's blue sky law where the sale of the security occurred entirely in another state"); *Cors v. Langham*, 683 F. Supp. 1056 (E.D. Va. 1988) (dismissing claim under Maryland's blue sky laws where the plaintiffs purchased their securities through a Virginia-based representative of the defendants and the acts complained of all took place in Virginia); *Singer v. Magnavox Co.*, 380 A.2d 969, 981-82 (Del. 1977) (refusing to apply Delaware Securities Act where plaintiffs were Pennsylvania residents and no part of the sale occurred in Delaware), *overruled in nonpertinent part on other grounds, Weinberger v. UOP*, 457 A.2d 701 (Del. 1983); *Enntex Oil & Gas Co. v. Texas*, 560 S.W.2d 494,

(continued...)
Section 15 claim against Lehman must also be dismissed.

497 (Tex. Civ. App. — Texarkana 1977, writ ref'd n.r.e.) (noting that the Texas Securities Act "only applies to disposition of securities within the state").

Notwithstanding this requirement, plaintiff Washington Board fails to allege that any part of the sale of the Enron notes occurred in Texas. Indeed, plaintiff Washington Board is alleged to be a Washington entity (Compl. ¶ 81(a)) and the alleged sellers of the securities, defendants Lehman and J.P. Morgan Chase, are New York-based investment banks. The only connection to Texas is that Enron, the issuer of the notes, is located here. But that fact alone is insufficient to permit the application of the Texas Securities Act. *See Revco*, 1991 WL 353385, at *14; *Allen*, 763 So. 2d at 1100-01. Accordingly, plaintiff Washington Board's Texas Securities Act claim must be dismissed.

2. Plaintiff Washington Board Has Not Pleaded The Circumstances Constituting Fraud With The Particularity Rule 9(b) Requires.

Even if plaintiff Washington Board had pleaded a sufficient nexus between Texas and the sale of the securities, its Texas Securities Act claim still would fail. The Texas Securities Act makes it unlawful to sell a security by means of "an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading." Tex. Rev. Civ. Stat. Ann. art. 581-33 (Vernon Supp. 2002). Plaintiff Washington Board incorporates all allegations of the Complaint into its claim under the Texas Securities Act. (Compl. ¶ 1017.) There is thus no question that the Texas Securities Act claim sounds in fraud. Indeed, unlike in their Third Claim for Relief, plaintiffs do not even bother attempting to disclaim fraud in their Fourth Claim for Relief.

Because plaintiffs' Texas Securities Act claim sounds in fraud, it must be pleaded with the particularity required by Rule 9(b) "for all averments of fraud." *See, e.g., Booth v. Verity,*

Inc., 124 F. Supp. 2d 452, 459-61 (W.D. Ky. 2000) (requiring plaintiffs to meet Rule 9(b) pleading standard with respect to their Kentucky blue sky law claims because Kentucky's blue sky statute parallels the federal securities laws and because it has been construed as sharing the same purpose as the federal law); *In re Lion Capital Group*, 44 B.R. 690, 695 (Bankr. S.D.N.Y. 1984) (testing claims under state blue sky laws under Rule 9(b)); *Sheldon v. Vermonty*, 53 F. Supp. 2d 1157, 1168 (D. Kan. 1999) ("although arising under Kansas law, plaintiff's state statutory securities fraud claims, as well as his claims for common law fraud, must satisfy the pleading requirements of Fed. R. Civ. P. 9(b)"); *see also Anheuser-Busch Cos. v. Summit Coffee Co.*, 934 S.W.2d 705, 708 (Tex. App. — Dallas 1996, no writ) (where the language of the 1933 Act and the Texas Securities Act does not materially differ, interpretations of the 1933 Act may be "reliable guides" in interpreting the Texas Securities Act). As demonstrated above, plaintiffs have not pleaded the circumstances constituting fraud with particularity as to Lehman. For this reason also, plaintiff Washington Board's Texas Securities Act claim must be dismissed.

IV. CONCLUSION

For the reasons set forth above, plaintiffs' Complaint fails to state a claim against Lehman and should be dismissed with prejudice.[19]

Dated: May 8, 2002

Respectfully submitted,

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[19] When a legal theory is untenable, as is plaintiffs' aiding and abetting case here, "no legitimate purpose is to be served by permitting Plaintiff to amend." *Special Situations Fund III, L.L.P. v. ViaGrafix Corp.*, No. 3:98-CV-1216-M, 2001 WL 182666, at *2 (N.D. Tex. Jan. 22, 2001). *See also Lemmer v. Nu-Kote Holding, Inc.*, No. 3:98-CV-0161-L, 2001 U.S. Dist. LEXIS 13978, at *43-46 (N.D. Tex. Sept. 6, 2001) (dismissing Milberg Weiss action for failure to plead with specificity and failure to adequately plead scienter).

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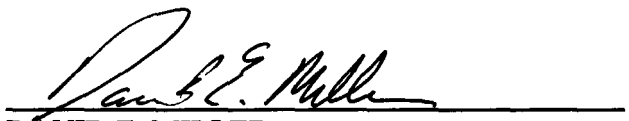
CERTIFICATE OF SERVICE

I hereby certify that on the 8th day of May 2002, a copy of the foregoing instrument was served on the counsel of record in this action by facsimile, e-mail or overnight delivery using the e-mail addresses, facsimile numbers and addresses listed on the attached Service List in accordance with the Federal Rules of Civil Procedure and the terms of the Order Regarding Service of Papers and Notice of Hearings dated April 4, 2002.



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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

In re ENRON CORPORATION SECURITIES LITIGATION	§	
This Document Relates To:	§	
MARK NEWBY, *et al.*, individually and on behalf of all others similarly situated,	§	
Plaintiffs,	§	
vs.	§	Civil Action No. H-01-3624
	§	(Consolidated)
ENRON CORP., *et al.*,	§	
Defendants.	§	
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, *et al.*, individually and on behalf of all others similarly situated,	§	
Plaintiffs,	§	
vs.	§	
KENNETH L. LAY, *et al.*,	§	
Defendants.	§	

ORDER GRANTING DEFENDANT
LEHMAN BROTHERS HOLDINGS INC.'S MOTION TO DISMISS

On this day came to be considered the Motion to Dismiss of defendant Lehman Brothers Holdings Inc. The Court, having reviewed the pleadings, papers, and arguments of counsel, finds that the Motion is well taken and should be granted. It is therefore:

ORDERED that the Motion to Dismiss of defendant Lehman Brothers Holdings Inc. is GRANTED, and plaintiffs' Consolidated Complaint for Violation of the Securities Laws against Lehman Brothers Holdings Inc. is hereby DISMISSED WITH PREJUDICE.

SIGNED and ENTERED this _____ day of _____, _____.

_____
MELINDA HARMON
UNITED STATES DISTRICT JUDGE

HU-10068v1